

City of Sarasota

Quarterly Investment Committee Report Quarter Ending December 31, 2005

Economic Developments

The economy that Alan Greenspan is about to hand over is in a much less healthy state than is popularly assumed. During much of his eighteen years in office, America enjoyed rapid growth with low inflation, and he successfully steered the economy around a series of financial hazards. However, Mr. Greenspan's departure could well mark a high point for America's economy, with a period of sluggish growth ahead. This is not so much because he is leaving, but because of what he is leaving behind – the biggest economic imbalances in American history.

One should not exaggerate Mr. Greenspan's influence – both good and bad – over the economy. Like all central bankers he is constrained by huge uncertainties about how the economy works, and by the limits of what monetary policy can do (it can affect inflation, but it cannot increase the long-term rate of growth). He controls only short-term interest rates, not bond yields, taxes or regulation. Yet for all these constraints, Mr. Greenspan has long been the world's most important economic policy maker – and during an exceptional period when globalization and information technology have been transforming the world economy. His reign has coincided with the opening up to trade and global capital flows of China, India, the former Soviet Union and many other previously closed economies. Mr. Greenspan's policies have also helped to support globalization: the robust American demand and huge appetite for imports that he facilitated made it easier for these economies to emerge and embrace open markets. The benefits to poorer nations have been enormous.

However, as far as the American economy is concerned, the Fed's policies of the past decade may have painful long-term costs. It is true that the economy has shown amazing resilience in the face of the bursting in 2000-01 of the biggest stock market bubble in history, of terrorist attacks and of a tripling of oil prices. Mr. Greenspan's admirers attributed this to the Fed's enhanced credibility under his charge. Others point to flexible wages and prices, rapid immigration, a sounder banking system and globalization as factors that have made the economy more resilient to shocks.

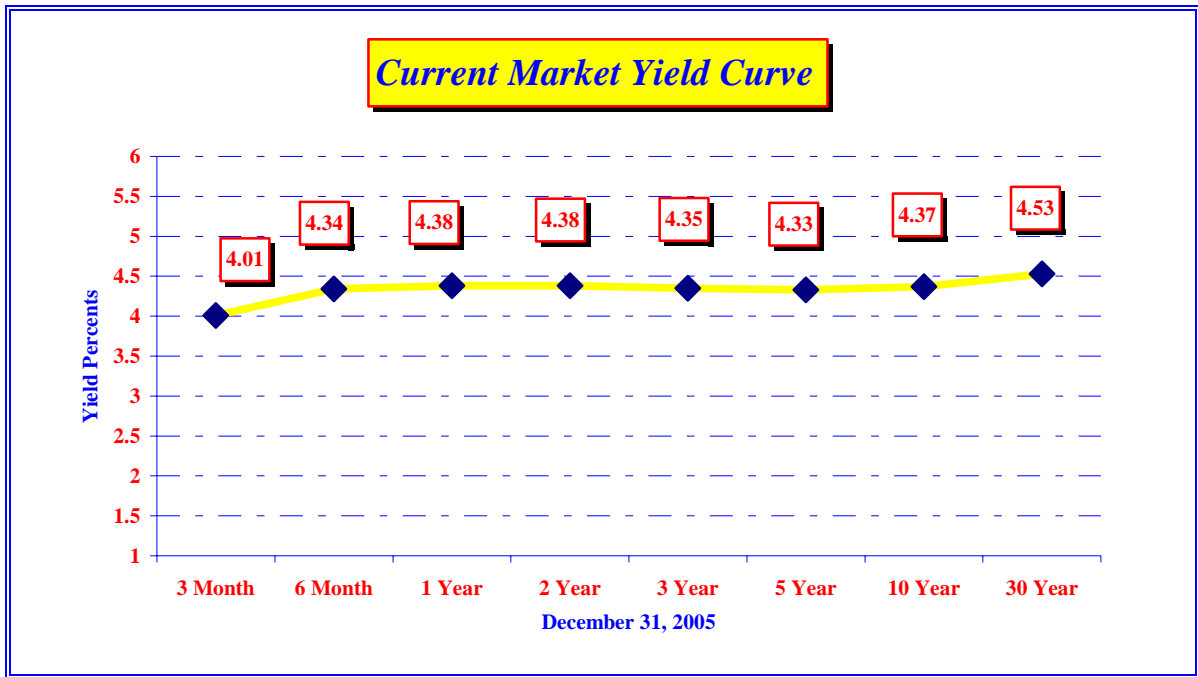
The economy's greater flexibility may indeed provide a shock absorber. A spurt in productivity has also boosted growth. But the main reason why America's growth has remained strong in recent years has been a massive monetary stimulus. The Fed held real interest rates negative for several years, and even today real interest rates remain low. Thanks to globalization, new technology and that vaunted flexibility, which have all helped to reduce the prices of many goods, cheap money has not spilled into traditional inflation, but into rising asset prices instead – first equities and now housing. Mr. Greenspan has been criticized for not trying to restrain the stock market bubble in the late 1990's, and then, after it burst, for inflating a housing bubble by holding interest rates low for so long. The problem is not the rising asset prices themselves but rather their effect on the economy. By borrowing against capital gains on their homes, households have been able to consume more than they earn. Robust consumer spending has boosted GDP growth,

(continued on page 4)

(Source: Wall St. Journal)

Treasury Yield Changes During the Fourth Quarter of 2005

	12/31/2005	9/30/2005	BP Change
3 Month	4.01%	3.47%	0.54%
6 Month	4.34%	3.78%	0.56%
1 Yr.	4.38%	4.11%	0.27%
2 Yr.	4.38%	4.17%	0.21%
3 Yr.	4.35%	4.18%	0.17%
5 Yr.	4.33%	4.19%	0.14%
10 Yr.	4.37%	4.33%	0.04%
30 Yr.	4.53%	4.57%	-0.04%



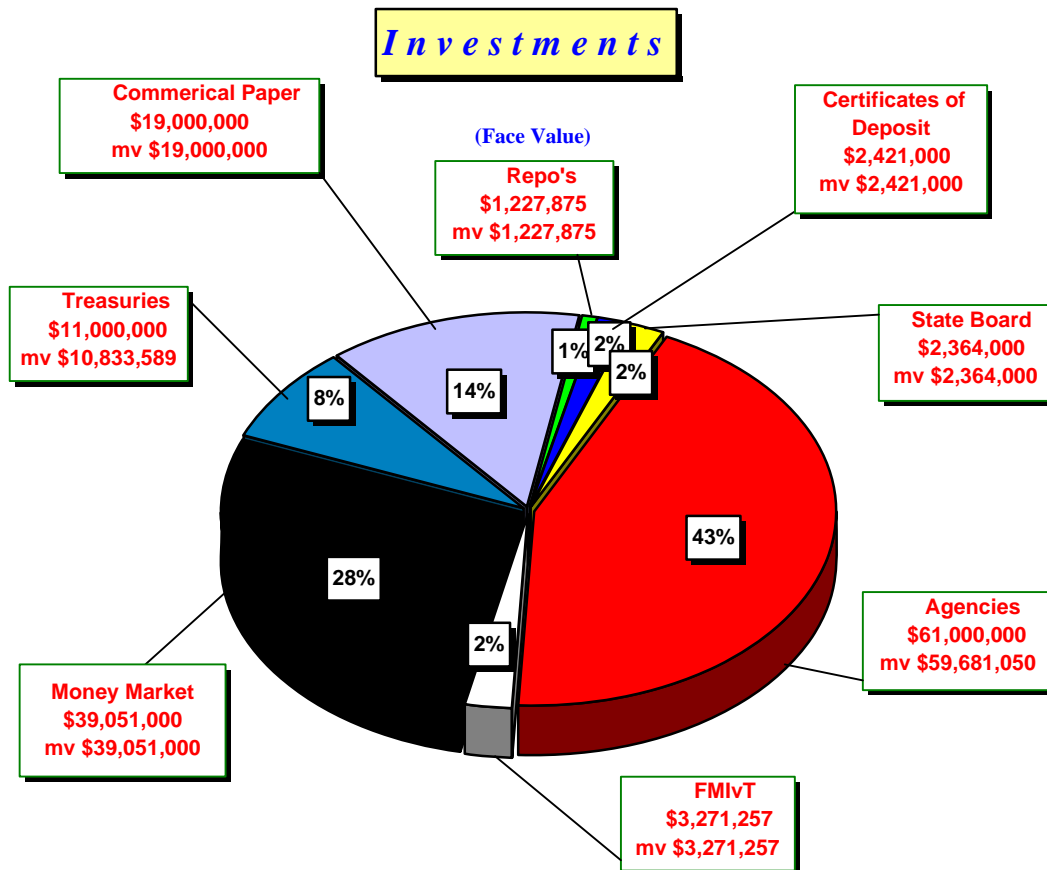
Interest Revenue V.S. Budgetary Expectation:

General Operating Fund

	<u>12/31/05</u>	<u>03/31/06</u>	<u>06/30/06</u>	<u>09/30/06</u>
Interest Revenue	\$384,595	\$000,000	\$000,000	\$000,000
Budgetary Expectation	<u>237,500</u>	<u>237,500</u>	<u>237,500</u>	<u>237,500</u>
Excess (Shortfall)	<u>\$147,095</u>	<u>\$(237,500)</u>	<u>\$(237,500)</u>	<u>\$(237,500)</u>

Water & Sewer Operating Fund

	<u>12/31/05</u>	<u>03/31/06</u>	<u>06/30/06</u>	<u>09/30/06</u>
Interest Revenue	\$ 32,635	\$ 00,000	\$ 00,000	\$ 00,000
Budgetary Expectation	<u>18,750</u>	<u>18,750</u>	<u>18,750</u>	<u>18,750</u>
Excess (Shortfall)	<u>\$ 13,885</u>	<u>\$(18,750)</u>	<u>\$(18,750)</u>	<u>\$(18,750)</u>



Total Investment - \$139,335,132

Market Value - \$137,849,771

Total Portfolio Weighted Avg. Maturity - 1.36 Years

CD'S & Agency Bond Weighted Avg. Maturity - 2.33 Years

(continued from page 1)

but at the cost of a negative personal savings rate, a growing burden of household debt and a huge current-account deficit. Ben Bernanke, Mr. Greenspan's successor, likes to explain America's current-account deficit as the inevitable consequence of a saving glut in the rest of the world. Yet a large part of the blame lies with the Fed's own policies, which have allowed growth in domestic demand to outstrip supply for no less than ten years on the trot. Part of America's current prosperity is based not on genuine gains in income or on high productivity growth, but on borrowing from the future.

As a result of weaker job creation than usual and sluggish real wage growth, American incomes have increased much more slowly than in previous recoveries. Over the past four years total private-sector labor compensation has risen by only 12% over the comparable period of the previous five expansions. Without strong gains in incomes, the growth in consumer spending has to a large extent been based on increases in house prices and credit. In recent months Mr. Greenspan has given warnings that house prices may fall, and that this in turn could cause consumer spending to slow. In addition, he suggests that foreigners will eventually become less eager to finance the current-account deficit. Central banks in Asia and oil-producing countries have so far been happy to buy dollar assets in order to hold down their own currencies. However, there is a limit to their willingness to keep accumulating dollar reserves. Chinese officials have recently

indicated that they are looking eventually to diversify China's foreign-exchange reserves. Over the next couple of years the dollar is likely to fall and bond yields rise as investors demand higher compensation for risk.

When rising home-prices flatten out, and therefore the room for further equity withdrawal dries up, consumer spending will stumble. Given that consumer spending and residential construction have accounted for 90% of GDP growth in recent years, it is hard to see how this can occur without a sharp slowdown in the economy.

INVESTMENT STRATEGY

With new Fed Chairman Bernanke in place it looks as though increases in short-term rates will continue for the next several Fed meetings. Therefore, U.S. Treasuries will be looked at more aggressively with the premise that rates will soon peak. Commercial Paper will also continue to be placed into the portfolio in the thirty to ninety day ranges with a rating of A1 P1 or better. Overnight liquidity will be reduced to 15% or approximately \$21 billion over the next several quarters and short-term (3-12 months) will remain at 10% or approximately \$14 billion. The medium term range (12-24 months) will be targeted at approximately 75% or \$104 billion of the portfolio. Long-term range (2-5 years) will continue to be reduced as call options are exercised; agencies securities mature or are sold.

Investment Policy

The City Commission adopted resolution NO. 01R-1397 on September 4, 2001, authorizing the Finance Director to invest surplus funds, as delegated by the City Manager. Quarterly reports are submitted to the investment

committee which consists of the City Manager, Finance Director, Cash and Investment Manager and the City Auditor and Clerk.

Performance Measurements:

- 1) 3.33% Target rate based on U.S. Treasury Market Securities at 12/31/2005.
- 2) 4.037% Rate of return based on Lehman Brothers 1-3 Yr. Index for U.S. Governments maturing in April 2008, which is the duration equivalent of the portfolio's weighted average maturity.
- 3) 3.99% Annualized rate of return based on portfolio Investment at 12/31/2005.
- 4) 3.25% Annualized rate of return based on Treasury, Agency and C. D. portion of the portfolio at 12/31/2005.

Authorized Investment Institution and Dealers:

Bank -

- 1) Wachovia Bank, NA

Region Firms -

- 1) Sun Trust Equitable Securities Corp.
- 2) Vining Sparks Securities
- 3) Shay Financial Services, Inc.
- 4) Brookstreet Securities Corp.
- 5) Sovereign Securities Corporation, LLC

Primary Dealers -

- 1) Morgan Stanley Dean Witter, Inc.
- 2) Paine Webber Incorporated
- 3) Solomon Smith Barney, Inc.
- 4) Prudential Securities

Periodical publications used as source documents for articles appearing in December report.

1. The Wall Street Journal
2. The Economist Magazine
3. U. S. News Magazine